

Under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred incident to sales of service. See 86 Ill. Adm. Code 140.101. (This is a GIL.)

July 27, 2007

Dear Xxxxx:

This letter is in response to your letter dated November 27, 2006, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at [www.ILTAX.com](http://www.ILTAX.com) to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

### **Background and Facts**

Our client ('Taxpayer') is engaged in the business of selling advertising and marketing services to unrelated third parties ('Advertiser'). The Taxpayer has recently entered into advertising/marketing agreements to distribute beverage cup sleeves bearing third party advertisements approved by the Advertiser to Cafés and other similar establishments ('Cafés'). All advertisements are in the form of text and/or graphics printed on the beverage cup sleeves provided by the Taxpayer. The Advertiser has final approval for all of the printed advertisements and artwork on the beverage cup sleeves before they are distributed to the Cafés.

### **Taxpayer's Agreement with the Advertiser**

The Taxpayer is the purchaser and owner of the beverage cup sleeves inventory and does not sell the beverage cup sleeves to the Advertiser purchasing the advertising and marketing services. The Advertiser is required to reimburse the Taxpayer based on a per unit quantity of beverage sleeves distributed to the Café displaying its approved advertising messages. The Taxpayer is required to regularly monitor the Café to confirm that the Café is distributing the beverage cup sleeves to its customers during the term of the advertising agreement.

## **Taxpayer's Agreement with the Café**

The Taxpayer has entered into an Exclusive Advertising Agreement ('Agreement') with the Café to distribute the beverage sleeves for the term of the agreement. The Agreement states in pertinent part:

1. The Taxpayer will be the exclusive supplier of all beverage cup sleeves carrying the advertisements of the Taxpayer and/or the Advertiser that the Café utilizes
2. Legal title to all beverage sleeves supplied by the Taxpayer shall pass to the Café upon delivery.
3. The Café agrees that to the extent of the beverage cup sleeves on hand, one will be placed on each cup of 'to go' hot coffee, hot tea, or other hot beverage that is served in the Café.
4. The Café acknowledges that Taxpayer's provision of the beverage cup sleeves to the Café hereunder is of significant value to the Café representing substantial cost to the Taxpayer, such that the Taxpayer is willing to bear such cost in order to obtain the exclusive right to advertise on beverage cup sleeves that are served or used in the Café. Accordingly, the Café, recognizing the value of these items and the related cost to the Taxpayer in providing these items, hereby grants an exclusive right to Taxpayer, and expressly agrees that beverage cup sleeves carrying third party advertisements ('Promotional Items') supplied by any vendor other than [sic] Taxpayer will not be served or used in the Café.
5. The Café agrees to use the most current beverage cup sleeves on hand in the Café. The Taxpayer may remove out dated sleeves and replenish the Café supply with the current beverage cup sleeves.
6. In those rare situations that the Taxpayer may not have on hand the requisite amount of inventory sufficient to supply the Café with the quantity of beverage cup sleeves required, it will contact the Café and provide the Café with the option of utilizing generic beverage cup sleeves (i.e., sleeves without advertisements). The generic beverage cup sleeves will be supplied by the Taxpayer at a discounted cost to the Café, provided, that when the Taxpayer again supplies the Café with its regular beverage cup sleeves (i.e., sleeves with advertisements), the Café will not use any generic sleeves.
7. The Café shall post in a conspicuous location in the Café reasonable signage, paid for and supplied by the Taxpayer, stating that the Café is subject to an exclusive advertising agreement with the Taxpayer. If Promotional Items supplied by any vendor other than the Taxpayer are delivered or otherwise brought into the Café, the Café shall (i) immediately notify the Taxpayer, (ii) inform the other vendor that the Café is subject to an exclusive advertising agreement with the Taxpayer, and (iii) return all Promotional Items to the other vendor. If the Café does not so inform the other vendor or return the Promotional Items, the Café hereby expressly authorizes the Taxpayer to do so, as the Café's authorized agent.

## **Definition of a Sale**

The general definition of a 'Sale' for sales/use tax purposes in most states includes any transfer of title, possession, or both, from a seller to a buyer. The transfer must be made for consideration which may be in the form of an exchange, or barter, conditional or otherwise, in any manner or by any means whatsoever, for tangible personal property.

The Agreement explains that legal title to the beverage cup sleeves transfers to the Café upon delivery and the Café will be contractually obligated to provide the service of placing a beverage cup sleeve on each beverage they served during the life of the Agreement. It is also acknowledged in the agreement that the transfer of the beverage cup sleeves represents a significant value to the Café and represents a substantial cost to the Taxpayer.

Based on the general definition of a sale and the obligations of both parties to the Agreement, we believe that the Taxpayer has made a sale of beverage cup sleeves to the Café.

### **Taxability Related to the Transfer of Beverage Cup Sleeves to the Cafés**

Given that the Taxpayer has a taxable presence with your state and that its customers (i.e., the Cafés) are located in your state, is the transfer of legal title to the beverage cup sleeves from the Taxpayer to the Café considered a sale subject to sales or use tax in your state?

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Should you have any questions, please contact myself.

### **DEPARTMENT'S RESPONSE**

We cannot provide a specific answer to your question in the context of a GIL. However, we hope that the following general information is helpful.

When a printing company contracts to print custom printed marketing literature, a special order printing situation exists and liability is incurred under the Service Occupation Tax Act. Who is liable for the tax in these situations depends upon the method chosen by the printer in calculating his Service Occupation Tax liability. See 86 Ill. Adm. Code 130.2000 and 140.101.

Retailers' Occupation Tax and Use Tax do not apply to receipts from sales of personal services. Under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred incident to sales of service. For your general information see 86 Ill. Adm. Code 140.101 regarding sales of service and Service Occupation Tax.

The purchase of tangible personal property that is transferred to service customers may result in either Service Occupation Tax liability or Use Tax liability for the servicemen, depending upon which tax base the servicemen choose to calculate their liability. Servicemen may calculate their tax base in one of four ways: (1) separately stated selling price; (2) 50% of the entire bill; (3) Service Occupation Tax on cost price if they are registered de minimis servicemen; or, (4) Use Tax on cost price if the servicemen are de minimis and are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of sales of service. The tax is based on the separately stated selling price of the tangible personal property transferred. If servicemen do not wish to separately state the selling price of the tangible personal property transferred, those servicemen must use the second method where they will use 50% of the entire bill to their service customers as the tax base. Both of the above methods provide that in no event may the tax base be less than the cost price of the tangible personal property transferred. Under these methods, servicemen may provide their suppliers with Certificates of Resale when purchasing the tangible personal property to be transferred as a part of the sales of

service. Upon selling their product, they are required to collect the corresponding Service Use Tax from their customers.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). See, 86 Ill. Adm. Code 140.101(f) enclosed. This class of registered de minimis servicemen is authorized to pay Service Occupation Tax (which includes local taxes) based upon the cost price of tangible personal property transferred incident to sales of service. Servicemen that incur Service Occupation Tax collect the Service Use Tax from their customers. They remit the tax to the Department by filing returns and do not pay tax to suppliers. They provide suppliers with Certificates of Resale for the property transferred to service customers.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). Such de minimis servicemen may pay Use Tax to their suppliers or may self-assess and remit Use Tax to the Department when making purchases from unregistered out-of-State suppliers. Those servicemen are not authorized to collect "tax" from their service customers because they, not their customers, incur the tax liability. Those servicemen are also not liable for Service Occupation Tax. It should be noted that servicemen no longer have the option of determining whether they are de minimis using a transaction by transaction basis.

The Department has recognized situations where printed materials are "used" outside Illinois and then placed for mailing by mail or common carrier outside Illinois for delivery into Illinois, and during which, the serviceman loses the ability to exercise control over the printed materials (e.g., to recall the materials). See for example ST 06-0004-PLR, ST 01-0166-Gill, and ST 01-0003-GIL. Generally, in those situations, a serviceman would not incur a Use Tax liability nor a Service Use Tax collection obligation if the serviceman does not retain the ability to exercise control over the shipment of the printed materials after entry into Illinois. This letter and the general information letters referenced above also describe the general tax liabilities of printers in special order printing situations. Such liabilities may accrue, if the serviceman were to have any control over the printed materials in this State.

If you require additional information, please visit our website at [www.ILTAX.com](http://www.ILTAX.com) or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Very truly yours,

Martha P. Mote  
Associate Counsel